

**REPORT CARD ON FY 2010 AUDITS**

**ISSUED BY**

**DEPARTMENT OF DEFENSE  
OFFICE OF THE INSPECTOR GENERAL**



**Prepared by the staff of  
Senator Chuck Grassley**

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## **Introduction -- Oversight Review of FY 2009 Audits**

This is a progress report on efforts to improve audit quality in response to recommendations made in Senator Grassley's oversight report issued in September 2010.

After receiving a series of anonymous letters from whistleblowers alleging gross mismanagement in the Audit Office within the Office of the Inspector General (OIG) at the Department of Defense (DOD), Senator Grassley's staff initiated an in-depth oversight review.<sup>1</sup> This work assesses audit reporting by the OIG. It began two years ago.

Senator Grassley's first assessment of audit reporting was published on September 7, 2010. It provided a thorough analysis of the 113 audits issued by the Audit Office during FY 2009. This report clearly showed that audit oversight capabilities, which cost the taxpayers \$100 million a year, were seriously degraded. It urged the IG to "hit the re-set button" and re-focus on the core mission as outlined by the IG Act of 1978. The report offered 12 specific recommendations for reforming the audit process and bringing it into alignment with the IG Act.

The gaping hole in oversight coverage, caused by the IG's degraded audit capability, leaves huge sums of the taxpayers' money vulnerable to fraud, waste, and outright theft. This is the driving force behind Senator Grassley's ongoing review of OIG audits. Audits are the IG's primary tool for exercising oversight. The audit is the tip of the IG spear, and it needs to have a finely honed cutting edge. Right now, it is disabled. Rather than being hard-hitting and on target, audits tend to drift around their intended targets, failing to reflect the clarity of purpose expected of IGs. Until the Audit Office regains its edge and audit quality improves, its subpar work will continue to fail the taxpayers and DOD clients.

## **Promised Reforms**

In the wake of last year's report, IG Heddell promised a comprehensive plan to bring about genuine audit reform.

First, IG Heddell made a firm commitment to "transform the Audit organization," consistent with many of the recommendations contained in Senator Grassley oversight report.<sup>2</sup> The new Deputy IG (DIG) for Auditing, Mr. Dan Blair, produced a roadmap for achieving transformation and improvement. Dated December 15, 2010, DIG Blair's report lays out a plan for improving the "timeliness, focus, and relevance of audit reports."<sup>3</sup> Most of the Blair reforms were to be put in place within 90 to 180 days – or by June 2011, though some were expected to take longer.

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<sup>1</sup> Senator Grassley received the first in a series of anonymous letters from Audit Office staff on January 31, 2009; the last one was received on April 14, 2011;

<sup>2</sup> Letter to Senator Grassley dated December 17, 2010;

<sup>3</sup> Office of the Deputy IG for Auditing Implementation Plan: Improving Relevancy and Timeliness, December 15, 2010;

Second, as part of the internal evaluation process in response to Senator Grassley's oversight review, the OIG asked two independent consulting firms – Qwest Government Services and Knowledge Consulting Group (KCG) – to conduct an “organizational” assessment of the Audit Office and its audit reports. Their report was issued on October 7, 2010.<sup>4</sup> These independent professionals seemed to reach the same conclusions as Senator Grassley's staff. The Qwest Report put it this way: “We do not believe Audit is selecting the best audits to detect fraud, waste and abuse.”<sup>5</sup> The Qwest report suggests that auditors have lost sight of that goal and that they need to “take a step back” and “refocus” on that core mission.<sup>6</sup>

The senior leadership at the OIG appears to have heard the Qwest message and taken it to heart. DIG Blair promised to create “a modern, world-class oversight organization providing benefit to the Department, Congress, and taxpayer.” IG Heddell assured Senator Grassley that Mr. Blair's roadmap clearly indicates that his office has already “hit the reset button.” All these promises are encouraging. But when will all these promises become a reality? When will audit quality improve? Those are big question marks right now.

These unanswered questions demand tenacious watch-dogging by all oversight groups.

### **When Can Improvement be Expected?**

The transformation plan was set in motion in December 2010. Under DIG Blair's roadmap, the first batch of reforms is scheduled to take effect mid-way through this year. At that point, about 50% of the FY 2011 audits will have already been published, and most of those would be unaffected by Mr. Blair's reforms, as they were “set in concrete” long before the transformation plan was even approved. In theory, therefore, the full impact of Mr. Blair's reforms will probably not begin to be reflected in published audit reports until late this year. Those will be the FY 2012 reports. That is not to say, however, that some “mid-course corrections” were not possible and improvements could come sooner, since formal discussions about the need for reform actually began almost two years ago.<sup>7</sup> Four of the five top scoring reports discussed later in this report, for example, were issued late in the 2010 reporting cycle. They appear to offer a glimmer of hope as to what may be coming down the pike.

### **“Report Card” on FY 2010 Audits**

In order to establish a solid baseline for assessing IG Heddell's transformation effort, Senator Grassley's staff has taken another snapshot of recent OIG audit reports. This oversight review is best characterized as an “Audit Report Card.”

Each of the 113 unclassified reports issued in FY 2010 was reviewed, evaluated and graded using the five rating categories described below:<sup>8</sup>

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<sup>4</sup> Audit Organizational Assessment by Qwest and KCG, October 7, 2010;

<sup>5</sup> Qwest Report, p. 29.

<sup>6</sup> Qwest Report, pp. 5, 18, 20, 29;

<sup>7</sup> Interviews with former Deputy IG for Auditing Mary Ugone, June 17, 2009, and June 25, 2009;

<sup>8</sup> Most of these reports are available on the DOD OIG web site: [www.dodig.mil.com](http://www.dodig.mil.com); However, 5 additional reports were security classified and are not reviewed in this report;

## **Rating Categories**

- 1) *Relevance*: Were audit objectives fully aligned with the core IG mission – to detect, report, and deter fraud, waste, theft, illegal and improper activities, and abuse and misuse of the taxpayers' money?
- 2) *Connecting the dots on the money trail*: Did the audit connect all the dots in the cycle of transactions? Did the audit examine, match, and verify all pertinent transaction data from contract requirements through actual payments? Did it determine whether the government received what it ordered at the agreed upon price and schedule?
- 3) *Strength and accuracy of recommendations*: Were the findings consistent with the evidence developed in the audit? Were the recommendations tough and appropriate? Were officials who were responsible for alleged fraud, waste and mismanagement held accountable through recommendations for administrative action or criminal investigations? Did the audit recommend steps be taken to recover fraudulent, unauthorized, erroneous or improper payments?
- 4) *Fraud and waste meter*: Did the audit carefully document the exact dollar amounts of alleged fraudulent, wasteful, unauthorized or improper payments and verify those dollar amounts at primary sources – either the Defense Finance and Accounting Service (DFAS) or other relevant accounting records?
- 5) *Timeliness*: How quickly was the report issued? Did it take 6 months or a year or more to publish?<sup>9</sup> Or did it take so long to complete that its findings and recommendations became stale or irrelevant?
- 6) *Junk-yard dog index*: This is the sum of grades awarded in each of the five above-mentioned rating categories divided by five or overall average for the report.

## **Grading System**

Each report was scored using the grading system shown below:

- 5.0 is equivalent to A or excellent;
- 4.0 to 4.9 is equivalent to B- to B+ or very good;
- 3.0 to 3.9 is equivalent to C- to C+ or good;
- 2.0 to 2.9 is equivalent to D- to D+ or poor;
- 1.0 to 1.9 is equivalent to F or fail;

For grading timeliness, the following procedure was used: Audits completed in 6 months or less received a 5 or A; Those completed in 6 to 9 months received a 4 or B; Those completed in 9 to 12 months received a 3 or C; Those taking 12 to 15 months received a 2 or D; and those that took over 15 months, received a 1 or F.

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<sup>9</sup> There is no specified goal for audit completion times; Last year the goal was 12 months, OIG email, 5/18/11;

After each report was graded individually, all the scores from each report in each rating category were added up and averaged to create a composite score for all 113 audit reports. That box score is presented on the “Report Card” shown below:

**Audit Report Card**  
**Composite Score for 113 Reports**

<b><u>RATING CATEGORIES</u></b>	<b><u>Grades<sup>10</sup></u></b>
Relevance	2.7 or D+
Connecting Dots on Money Trail	2.0 or D-
Strength & Accuracy of Recommendations	1.9 or F
Fraud & Waste Meter	1.6 or F
Timeliness (average of 13 months to complete)	2.3 or D
<b>Junkyard Dog Index</b>	<b>2.1 or D-</b>

**Overall Assessment**

The composite score of 2.1 or D- awarded to the 113 audit reports is very low indeed. Admittedly, the grading system used is subjective and imperfect. As inexact as this method of evaluation may be, Senator Grassley’s oversight staff has determined that this is a reasonable or rough measure of overall audit quality. Should the score be a C or D? While there may be disagreement about how low the grade should be, there is probably little disagreement as to why the grade is low. The low mark is driven by pervasive deficiencies that surfaced in every report examined – with 15 notable exceptions.<sup>11</sup> Those deficiencies are the same ones pinpointed in the Qwest Report. Instead of being hard-core, fraud-busting contract or financial audits, most reports were policy and compliance reviews with zero fiscal impact. Some of this work might have been more appropriately performed as DOD staff or think tank studies rather than as independent audits. The auditors were not on the “money trail” 24/7 aggressively rooting out fraud, waste, theft, and abuse of the taxpayers’ money -- as mandated by the IG Act.

The fact that audits are not aligned with the core IG mission is confirmed in the independent Qwest/KCG study commissioned by IG Heddell in response to Senator Grassley’s first report. The October 2010 Qwest/KCG report zeroed right in on the central issue:

<sup>10</sup> Top Score is A – Excellent; Middle of the road score is C - Good; Lowest score is F – Fail;

<sup>11</sup> The 15 best reports that were rated as good to very good are evaluated on pages 6-13 of this report;

“We do not believe Audit is selecting the best audits to detect fraud, waste and abuse. The organization doesn’t audit what truly needs to be audited. Some audits hold little value in the end.”<sup>12</sup>

Those are independent professional consultants talking, and they hit the nail square on the head. Detecting and deterring fraud and waste is the IG’s job. That is the main reason for the IG’s existence. Doing policy and compliance reviews – as they consistently did in FY 2009-10 – will not put them in the fraud detection business or help to strengthen their credibility within the Pentagon. The Pentagon bureaucrats have devoted significant civilian and military resources to drafting, implementing, and enforcing volumes of policies. By conducting policy audits, the OIG is further cementing its reputation as paper pontificators whose recommendations do very little to produce cost savings or root out fraud and waste. It’s like they are howling in the wilderness. To change that perception, OIG personnel need to be on the “money trail” 24/7 from the moment an audit is initiated. Auditors must examine financial transactions. This is where fraud is mostly likely to occur. This is where the auditors need to go to find it. This is what the OIG audit manuals instruct auditors to do: “think fraud” and “plan audits to provide a reasonable assurance of detecting fraud.”<sup>13</sup>

**There is one bright spot – a glimmer of hope. The auditors got it mostly right in 5 reports and partially right in 10 other reports. Those 15 reports, which constitute 13.3% of total assessed output in FY 2010, earned grades of good to very good overall. These fine reports prove that the Audit Office is capable of producing quality audits.**

### **Best & Worst**

#### **Five Best Report Cards – Model for the Future**

There were five exceptional reports produced in FY 2010. They were rated good to very good, earning relatively high scores of C+ to B- with excellent scores in several categories. They involved some credible and commendable audit work. Each one deserves a gold star.

All five of these reports involved down in the trenches, nitty-gritty audit work. They presented tough recommendations. In most, acceptable levels of accountability were sought. There were at least 10 criminal referrals to the Defense Criminal Investigative Service (DCIS) and the Army Criminal Investigation Division (CID). The “recovery and reimbursement” for illegal, improper, or erroneous payments was called for. Because hard-hitting contract and financial audits of this nature are so challenging and time-consuming, these five reports took an average of 21 months to complete. Such long completion times kept these fine reports from being awarded top scores of 5.0 or A. Long production times causes information to turn stale, which undermines audit impact and relevance. Had they been completed within six months, for example, they would have earned high B+ scores. Such complex audits demand management attention. At present, there are no specified goals for audit completion times. They are needed. Then audit teams can be organized with the right skill sets to meet those goals.

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<sup>12</sup> Qwest Report, pp. 28-29;

<sup>13</sup> DOD Audit Manual No. 7600.07M, February 13, 2009, signed by IG Heddell, p. 45; and Handbook on Fraud Indicators, March 31, 1993, p. I;



Individual report cards on the top five audits are presented below. Each one is followed by a brief evaluation of that report's strengths and weaknesses plus some recommendations regarding the need for more aggressive audit follow-up work. This is meant to be a constructive, educational exercise. It is hoped that the analyses accompanying those 5 report cards will serve as a guide and learning tool for auditors and managers alike and help them sharpen their skills and put them on path to reform and transformation.

The grading system used to mark the top five reports – and to zero in on their strengths and weaknesses -- is embedded in the five evaluation categories outlined on page 4 of this report. These are the same standards used to produce the composite score of 2.1 or D- for all 118 reports. If those guidelines were adopted and followed, auditors would begin producing audits that detect, report, and verify fraud, waste and abuse and make appropriate recommendations for corrective action. If the auditors follow those simple guidelines, they will hopefully begin producing top-quality audits and reach the goals prescribed by the IG Act.

The top five audit report cards follow:

**# 1 -- Foreign Allowances and Differentials Paid to DOD Civilian Employees Supporting Overseas Contingency Operations, Report No. 2010-075, 8/17/10:**

**Audit Report Card**

<b><u>RATING CATEGORIES</u></b>	<b><u>Grades</u></b>
Relevance	5.0 or A-
Connecting Dots on Money Trail	5.0 or A-
Strength & Accuracy of Recommendations	4.0 or B-
Fraud & Waste Meter	5.0 or A-
Timeliness (16 months to complete)	1.0 or F
<b>Junkyard Dog Index</b>	<b>4.0 or B-</b>

**Evaluation – Strengths & Weaknesses**

This audit examined the accuracy of \$213 million in payments to 11,700 DOD civilians in FY 2007-2008 for “danger and hardship” allowances associated with overseas duty. After reviewing the relevant DFAS payment records, the auditors determined that DFAS had made improper payments – underpayments and overpayments – totaling \$57.7 million. The audit recommended that the DFAS Director “take appropriate corrective action to reimburse or recover the improper payments” and that new policies and procedures be put in place to preclude erroneous payments of this sort in the future.

This was excellent audit work. It may be the best report. The auditors went to the primary source pay records and verified and documented the scope of the problem. The recommendations were good but did not go far enough. Tightening up procedures is fine, but who was accountable for the sloppy accounting work that led to all the erroneous payments? Did the Audit Office follow up to determine whether the DFAS Director had taken steps to reimburse underpayments and to recover the overpayments? The answer is probably: No. On February 23, 2011, in response to a question, DFAS reported to Senator Grassley's office that DOD is still "developing a policy" to fix the problem, and once that process is completed, DFAS will "take appropriate corrective action to reimburse or initiate collection action."<sup>14</sup> One problem with this "reimburse or recover" effort is the passage of too much time. For starters, it took 16 months to complete this audit that was published last August. Some of the payments in question were made as far back as 2006-2007 or up to 4 or 5 years ago. As time passes, the feasibility of reimbursement or recovery of money becomes less likely.

**# 2 -- Demographic Data Supporting the DOD Mass Transportation Benefit Program  
Within the National Capital Region, Report No. 2010-053, 4/16/10:**

**Audit Report Card**

<b><u>RATING CATEGORIES</u></b>	<b><u>Grades</u></b>
Relevance	4.8 or B+
Connecting Dots on Money Trail	4.5 or B
Strength & Accuracy of Recommendations	4.8 or B+
Fraud & Waste Meter	4.8 or B+
Timeliness (26.5 months to complete)	1.0 or F
<b>Junkyard Dog Index</b>	<b>3.98 or C+</b>

**Evaluation – Strengths & Weaknesses**

The purpose of this audit was to assess the reliability of data used to determine eligibility for subsidies under the \$35 million Mass Transportation Benefits (MTB) program in FY 2007. After conducting an in-depth examination of pertinent documentation, the auditors determined that 32,500 of 41,000 participants in the MTB program were probably ineligible to receive mass transit subsidies and were, at the same time, improperly receiving subsidized parking benefits. The report verified that some \$12 million in improper and unauthorized payments were made. Nine potential fraud cases were referred to DCIS for possible investigation, and DOD was asked to "recoup erroneous benefits" paid to participants.

<sup>14</sup> Email from DFAS, February 23, 2011;

This was an excellent piece of work and should be a model for the kind of aggressive audit work that needs to be applied to high-dollar weapons and support contracts. The MTB program, by comparison, is “small potatoes.” This report had other shortcomings, as well. First, the auditors did not reconcile subsidies with primary source DFAS payment records. Second, it took far too long to complete – 26.5 months – and addressed issues with FY 2007 subsidies in a report that was published in 2010. And now we are mid-way through 2011 still seeking accountability and recovery of erroneous payments made 4 to 5 years ago. In response to a question from Senator Grassley’s office, OIG reported on March 14, 2011, that “DOD has not recouped any of the erroneous payments” identified in this report. A “recoupment effort” is still being studied and coordinated in the Pentagon with final resolution projected for April 2011. In addition, the Assistant U.S. Attorney has declined prosecution of the nine cases referred to DCIS, but those cases have been referred to “relevant agencies for civil/administrative remedy,” according to an OIG memo dated March 23, 2011.<sup>15</sup> In view of the fact that the Recovery Act has doubled the cost of the MTB program, the Audit Office should consider conducting another aggressive, follow-up audit of the MTB program. It obviously needs continuous oversight.

**# 3 -- Public Works Operations at U.S. Army Garrison-Yongsan, Korea, Report No. 2010-057, 5/4/10:**

**Audit Report Card**

<b><u>RATING CATEGORIES</u></b>	<b><u>Grades</u></b>
Relevance	4.0 or B-
Connecting Dots on Money Trail	4.5 or B
Strength & Accuracy of Recommendations	4.5 or B
Fraud & Waste Meter	4.5 or B
Timeliness (14.5 months to complete)	2.0 or D-
<b>Junkyard Dog Index</b>	<b>3.9 or C+</b>

**Evaluation – Strengths & Weaknesses**

This report assessed contractual activities at the Directorate of Public Works (DPW) at the U.S. Army Garrison, Yongsan, Korea.

<sup>15</sup> OIG emails dated March 14 and 23, 2011;

In FY 2008, this organization provided goods and services valued at \$75.0 million. The audit examined \$7 million in contract actions and purchases plus another \$393,000.00 in purchase card transactions. In FY 2004-2005, the Army Audit Agency and CID had uncovered fraudulent activity at another DPW office in Korea. The improved control environment found at DPW-Yongsan in this audit was attributed to effective corrective action taken in the wake of those earlier Army investigations. However there were still significant issues with improper payments – especially payments “for work not performed.” The report identified \$569,851.00 in “Potential Monetary Benefits,” that is, potential fraud and waste and \$79,851.00 in overpayments. This was a nitty gritty contract audit but again, just “small potatoes.” It was thorough and credible but not quite complete. There is one major flaw in audit methodology. The auditors did not verify payments against primary source accounting records. They concentrated on using delivery orders to verify that the government received what it ordered. That’s excellent, but it’s just one crucial dot on the money trail in the cycle of transactions. Using delivery orders to also verify payments is a questionable audit procedure. They needed to go the extra mile and match delivery orders with invoices, contract requirements and finally with payment vouchers. By doing that, they could have verified that the government received what it ordered at the agreed-upon price. The report makes some reasonable recommendations, including a proposal to “recover overpayments of \$79,851.00.” But there is no recommendation for holding responsible officials accountable for all the waste, mismanagement and overpayments. In addition, it is hard to believe that it took this audit team 14.5 months to audit \$7 million in DPW contracts. While the Army appeared to agree with the recommendations in the report, there is no indication that the Audit Office followed up to determine whether any money was, in fact, recovered.

**# 4 -- Army Use of Time-and-Materials Contracts in Southwest Asia, Report No. 2010-081, 8/27/10:**

**Audit Report Card**

<b><u>RATING CATEGORIES</u></b>	<b><u>Grades</u></b>
Relevance	4.5 or B
Connecting Dots on Money Trail	4.5 or B
Strength & Accuracy of Recommendations	4.5 or B
Fraud & Waste Meter	4.0 or B-
Timeliness (21 months to complete)	1.0 or F
<b>Junkyard Dog Index</b>	<b>3.7 or C+</b>

## **Evaluation – Strengths & Weaknesses**

This report reviewed Time-and-Materials (T&M) contracts in Southwest Asia valued at \$605 million. Its purpose was to determine whether these sole-source arrangements were justified and whether prices paid were fair and reasonable. The auditors “analyzed hundreds of invoices” to assess labor rates and price reasonableness, but there are no indications that they verified what was, in fact, paid against primary source DFAS documents. The report uncovered major problems, including invalid sole-source justifications, unreasonable prices, overpayments of \$3.7 million, and a failure to justify the use of T&M contracts that typically demand enhanced surveillance. The report made unusually forceful recommendations by asking the Army to “initiate appropriate administrative action” against the contracting officers responsible for the mismanagement and waste identified in the report. It also asked the DCAA<sup>16</sup> to review these contracts and obtain reimbursements of all erroneous charges. After spending 21 months reviewing these contracts why buck the audit to DCAA to complete? Why didn’t the Audit Office complete it? Has the Audit Office followed up to determine whether the requested DCAA audit is complete? The answer is probably: No. Senator Grassley’s office contacted DCAA on February 15, 2011, regarding the audit status. On March 1, 2011, DCAA “confirmed that it had not been asked to do the review but was coordinating with the Army to determine if an audit is required.” According to an OIG memo, dated April 7, 2011, the Army reported that the DCAA audit would be completed by September 2011 and that DCAA was negotiating with the contractor to recover overpayments.<sup>17</sup> However, no action has been taken against the contracting officers involved.<sup>18</sup> The Audit Office needs to do much more aggressive follow-up work to make sure the DCAA audit is done, and the contractors refund all overpayments.

### **# 5 -- Internal Controls Over the Army, General Fund Cash and Other Monetary Assets Held in Southwest Asia, Report No. 2010-034, 1/8/10:**

#### **Audit Report Card**

<b><u>RATING CATEGORIES</u></b>	<b><u>Grades</u></b>
Relevance	4.5 or B
Connecting Dots on Money Trail	4.5 or B
Strength & Accuracy of Recommendations	4.0 or B-
Fraud & Waste Meter	4.5 or B
Timeliness (23.5 months to complete)	1 or F
<b>Junkyard Dog Index</b>	<b>3.7 or C+</b>

<sup>16</sup> Defense Contract Audit Agency (DCAA)

<sup>17</sup> DCAA email dated March 1, 2011; OIG email dated April 7, 2011;

<sup>18</sup> OIG email dated May 10, 2011;

## **Evaluation – Strengths & Weaknesses**

The purpose of this audit was to determine whether \$2.4 billion in Army cash assets at 13 disbursing offices in Afghanistan, Egypt, Saudi Arabia, Iraq, and Kuwait were properly accounted for and safeguarded. To verify the accuracy and completeness of cash balances at these locations, the auditors examined primary source documents like the daily Statements of Accountability and other pertinent payment and collection records. During the course of the audit, they uncovered a major “irregularity” at the disbursing station located in Riyadh, Saudi Arabia – “an unreconciled U.S. Treasury Limited Depositary Account difference of \$2.9 million.” The Army’s Financial Command (FINCOM) then sent an analyst to Saudi Arabia to assess the scope of the discrepancies identified by the OIG audit team. This analyst re-confirmed the existence of \$2.9 million in “cash withdrawal irregularities” and requested an Army CID investigation. Since significant actions were taken by the Army to address the issues identified in the report, no other recommendations were offered. This is a good piece of audit work, but like so many others, it does not go the “extra mile.” Why did the OIG audit team fail to document all the facts and make the referral to DCIS or Army CID? There was no need for a second FINCOM audit team to travel to the Saudi disbursing station to re-confirm the facts already confirmed by the OIG audit team. That was a waste of money. And what about the other discrepancies noted in the report – like “deficient quarterly cash verifications” detected at other disbursing stations and the unauthorized use of \$544,000.00 in cash for invitational travel? Who was accountable for those lapses? Has the Audit Office done any follow-up to determine the status of the Army CID investigation, or whether the \$2.9 million was recovered and returned to the U.S. Treasury?

## **Good Reports**

In addition to the top five reports discussed above, there were another ten reports that were rated as good, earning C scores.<sup>19</sup>

These reports showed great potential but incurred major deficiencies in any one of the following key areas: 1) A failure to connect the dots between contract requirements and payments; 2) A failure to verify financial transactions using primary source accounting records; 3) Weak recommendations that fail to seek accountability where appropriate or to seek recovery of lost or wasted tax dollars; 4) Focusing on “small potatoes” – relatively small amounts of money or small contracts or small portions of large contracts; and 5) Long completion times, averaging 15 months with three in the 20-21 month range.

The report card presented below is a prime example of a good report that might have been much better were it not for critical deficiencies in key areas as follows:

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<sup>19</sup> The 10 FY 2010 reports that earned C scores were: 2010-027; -031; -035; -037; -042; -045; -046; -076; -086; -088;

**Defense Logistics Agency Contracts for M2 Machine Gun Spare Parts in Support of Operations in Southwest Asia, Report No. 2010-035, 1/11/10:**

**Audit Report Card**

<b><u>RATING CATEGORIES</u></b>	<b><u>Grades</u></b>
Relevance	4.5 or B
Connecting Dots on Money Trail	4.0 or B-
Strength & Accuracy of Recommendations	2.0 or D-
Fraud & Waste Meter	4.0 or B-
Timeliness (20 months to complete)	1 or F
<b>Junkyard Dog Index</b>	<b>3.1 or C-</b>

**Evaluation – Strengths & Weaknesses**

This audit did a thorough and credible job of assessing the quality and timeliness of deliveries of M2 50 caliber machine gun parts. However, since the audit determined that contractors had delivered defective parts and made late deliveries, the report needed to fully explore all aspects of the key contract audit question: Did the government receive what it ordered at the agreed-upon price and schedule? This audit grappled with relevant quality and schedule issues but not all relevant pricing and payment issues. The auditors correctly determined that the government did not receive what it ordered on the agreed-upon schedule. The report identified 7,100 “nonconforming” parts delivered on 24 contracts. It also found significant numbers of “backorders” on critical parts, including 4,097 for the highest priority parts during one 12-month period. That’s good, solid audit work. But to sharpen the focus on defective parts and late deliveries, the audit needed to examine these questions: How much was the government required to pay for the parts examined by auditors? What did it, in fact, pay for those parts? And what should it have paid for those parts after adjustments for defective parts and late deliveries? All pertinent data needed to be laid out in a separate section on pricing. That would have helped to clarify the issues and strengthened the report. Its recommendations were also weak and failed to “go the extra mile.” The report never questioned why the government spent \$655,000.00 to correct quality deficiencies -- without requesting reimbursements and penalties; or why the Defense Logistics Agency (DLA) made no effort to recover \$405,000.00 in reimbursements for late deliveries.

Contracting officials, who were responsible for accepting defective parts and late deliveries without demanding adequate monetary compensation, should have been recommended for appropriate disciplinary or administrative action. And they also should have been made accountable for the collection of all overpayments. Their conduct demonstrated a patent disregard for the interests of the taxpayers -- and more importantly -- for the troops in the field. The delivery of defective machine gun parts and the failure to deliver critically needed parts on time had the potential of placing troops engaged in combat operations in mortal danger. The need for accountability here was crystal clear yet totally ignored by the auditors who prepared this report.

### **Worst Reports**

The rest of the 2010 reports -- 98 in all or 86.7% of total output -- earned grades of D or F.<sup>20</sup> Some were mandated by Congress. They are prime examples of audits targeted in the Qwest Report. They were not designed to detect fraud and waste. They did not audit what truly needs to be audited. And most had little or no value.<sup>21</sup> The report card shown below is typical of the worst reports. This report -- **Defense Contract Management Agency Acquisition Workforce for Southwest Asia, Report No. 2010-051, 4/8/10** -- received the lowest grade given to any report:

### **Audit Report Card**

<b><u>RATING CATEGORIES</u></b>	<b><u>Grades</u></b>
Relevance	1.0 or F
Connecting Dots on Money Trail	1.0 or F
Strength & Accuracy of Findings & Recommendations	1.0 or F
Fraud & Waste Meter	1.0 or F
Timeliness (18 months to complete)	1.0 or F
<b>Junkyard Dog Index</b>	<b>1.0 or F</b>

### **Evaluation**

The purpose of this report was to determine whether the Defense Contract Management Agency (DCMA) had adequate manpower to oversee contracts in Southwest Asia (SWA). It concluded that DCMA was unable to determine its SWA workforce requirements, and there was no plan for developing a plan. The report recommended that DCMA "define acquisition workforce requirements for SWA." This appears to be appropriate subject matter for a DOD staff study or think tank analysis -- not an independent OIG audit.

<sup>20</sup> Total includes 12 "boilerplate" reports on un-auditable financial statements plus two partial opinions;

<sup>21</sup> Qwest Report, pp. 28-29;



This is one of many policy/compliance reviews but is unique in that there was no policy to review, yet it still took 18 months to finish. This audit should have been terminated early on, but as the Qwest Report indicates, “there is no process for stopping audits that are no longer relevant.”<sup>22</sup> What redeeming value did this report offer to the taxpayers? This audit – like so many others like it – did not focus on fraud and waste, and, not surprisingly, it found none. DCMA has a long history of exercising lax contract oversight. OIG resources would have been better spent auditing one of DCMA’s \$1.3 trillion in contracts.

Four other reports were blatantly wasteful of precious taxpayer dollars. Two of these were virtually identical in content and therefore duplicative.<sup>23</sup> Two others were nothing more than summaries of 293 old audits issued from 2004-2010. They contained no recommendations and appeared to have no redeeming value.<sup>24</sup> At a cost of \$800,000.00 each, these reports constitute a blatant waste of several million dollars. All earned grades of D or F.

### **Stimulus Project Reports – ZERO Benefit to Taxpayers**

There were 27 memo-style audits of “Stimulus” projects. These were required by the Recovery Act enacted by Congress. Tiger teams should have been formed to tackle these controversial projects. Unfortunately, the opposite occurred. These are the worst-of-the-worst. They contained no findings of any consequence. They offered few – if any – recommendations. Most did not even identify the costs of the projects audited. The taxpayers were deeply concerned about the value of these so-called “shovel-ready jobs. They expected aggressive oversight. They needed assurances that all this money was not wasted. None of those concerns were addressed and resolved by these questionable reports. Instead of being probing audits, they were more like an OIG stamp of approval.

### **Shorter Reports Skew Production Totals**

The inclusion of so many short memo-style reports in the 2010 totals helped skew the production numbers. In FY 2009, it took an average of 18 months to publish a report. In FY 2010, by comparison, it took an average of 13 months to publish reports – a reduction of 28%. However, this improvement may have been achieved by questionable means – with shorter, less complex reports. The average report length dropped from 42.5 pages in 2009 to 32.1 pages in 2010 or 25%. All these reports earned poor grades – except for timeliness. The average time to complete the 27 Recovery Act compliance memo-style audits, for example, was a relatively low 9.6 months.

### **Productivity & Cost – DOD-OIG**

The Audit Report Cards presented in the previous section focused mainly on audit quality. Issues pertaining to low productivity and high costs – while extremely important -- were not suitable for grading and inclusion in the Report Card. So, they are examined separately here.

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<sup>22</sup> Qwest Report, p. 28;

<sup>23</sup> Report No. 2010-001 and -023;

<sup>24</sup> Report No. 2010-002 and -090;

Beginning in 1995 -- with the exception of spikes in 1999 and 2006-08, audit output began a steep nose dive that is continuing. In 2009 and 2010, audit production reached near all-time lows of 113 and 118 reports respectively. Only 1990 and 2005 were lower with 103 and 111 reports respectively.

Figures 1 and 2 in the Appendix of this report portray the trend in audit production and staffing from 1990 to 2010.<sup>25</sup>

Figure 2 indicates that auditor productivity peaked in FY 1999 at 0.42 reports per staff but then fell to an average of 0.152 reports per auditor in FY 2009-10, a twenty-one year low. That is a 65% drop in auditor productivity over the past 12 years.

The steep nose dive in auditor productivity since 1999 raises serious questions about the leadership ability of top management and the continuing demand for more audit staff. Which specific factors account for the drastic decline in auditor productivity are not known with certainty.

Senior management claims the drop in production was caused by the steady loss of experienced auditors combined with a sudden influx of inexperienced YA-1 entry-level auditors. This theory appears plausible, as it is unlikely that new YA-1s possessed the necessary skills to meet the demands of auditing complex DOD contracts. However, management should have taken decisive action early on to reduce the impact of these adverse trends. It could have restructured the organization to ensure that each audit team had the right skill sets, experience levels, and robust size to tackle complex contract tasks in a way that was consistent with the core mission.

### **Comparative Performance With Other OIG Audit Offices**

The DOD OIG operates the largest and most costly audit office in the government. So as not to evaluate that Audit Office in a total vacuum and to help bring its performance into sharper focus, other similar audit offices were asked to provide comparable data on budgets, production, staffing, and costs. Those include the following: Health and Human Services (HHS), Housing and Urban Development (HUD), and the Department of Homeland Security (DHS).

Pertinent budget, staff and production data for DOD, HHS, HUD, and DHS are portrayed in Figures 3, 4, and 5 in the Appendix.

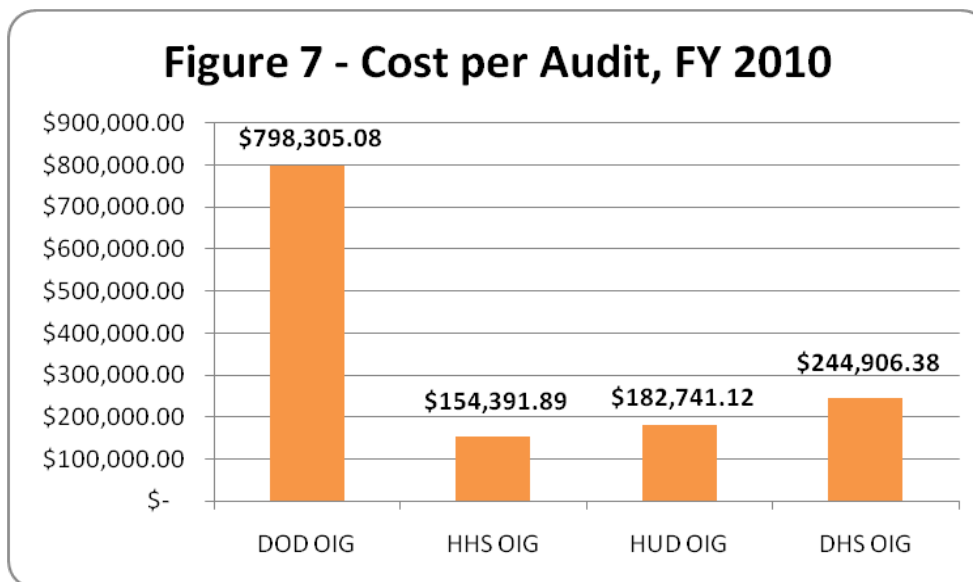
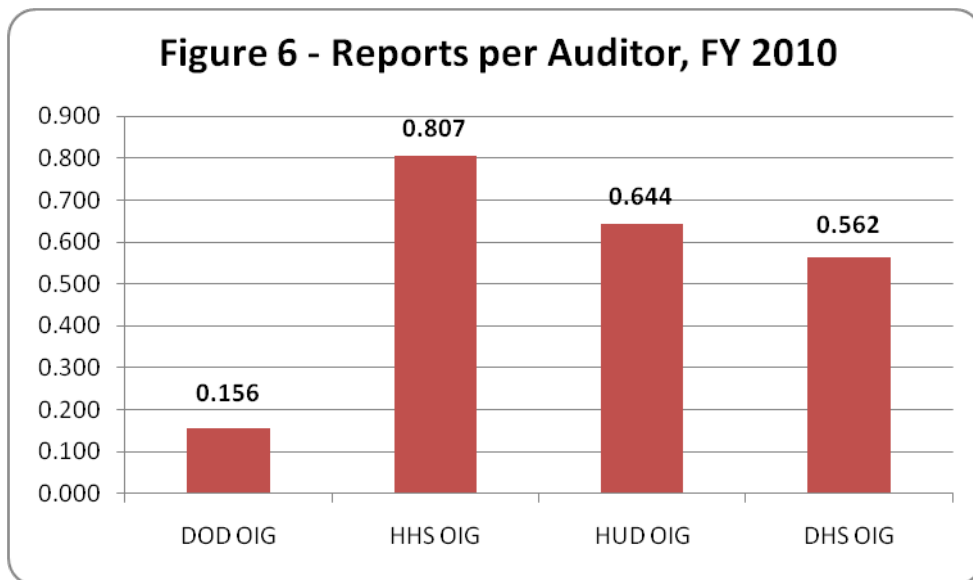
In 2010, at the three other audit offices -- HHS, HUD, and DHS, average audit costs ranged from \$154,000.00 to \$245,000.00, while average output per auditor per year was 0.562 to 0.807. By comparison, the overall DOD auditor productivity was much lower at 0.156, while the average cost per audit was much higher at \$798,305.08.<sup>26</sup>

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<sup>25</sup> Information in Figure 1 was derived from audit reporting data on the DOD OIG web site [www.dodig.mil](http://www.dodig.mil) and OIG information papers, including an email dated February 18, 2011;

<sup>26</sup> Audit unit costs are established by dividing total audit budget by total audits produced;

Audit cost and productivity data for DOD versus HHS, HUD, and DHS are shown in Figures 6 and 7 below:



The two graphs on the preceding page highlight a striking contrast. They show that DOD auditors are being significantly outperformed by their peers and by very substantial margins, indeed. Their peers in the other audit offices may be five times more productive than they are and able to produce audits at a quarter of their costs. These statistics appear to indicate that something may be drastically wrong in the DOD Audit Office.

If DOD was conducting complex end-to-end contract audits, then this might not be a fair apples-to-apples comparison. However, most of the audits produced by DOD are best characterized as “soft” policy and compliance reviews, while the competition is producing financial audits. This may, in fact, be a fair comparison – with one caveat. While the staff examined comparative cost and productivity data from all four audit offices, it did not evaluate the quality of the audits produced by HHS, HUD, and DHS – as it did for DOD in this report.

For these reasons, Deputy IG for Auditing Blair needs to provide a satisfactory explanation for these apparent disparities, because they raise a fundamental question about management and leadership. In the absence of a valid explanation, Mr. Blair may need to “hit the re-set button” on audit production and costs, as well.

### **Conclusions: Roadblocks To Reform And Transformation**

An overarching pattern of audit deficiencies appears to be common to most – if not all -- reports examined to date. The staff characterizes these as major roadblocks to effective auditing. These problems adversely affect every aspect of audit reporting. They were observed in the FY 2009 reports reviewed last year and again this year during the review of the FY 2010 audits – with a few exceptions. Until corrected and/or eliminated, these obstacles spell doom for the quality of OIG audit reports. Fixing them will clear the path to reform and transformation.

Major barriers standing in the way of effective audits are summarized below:

#### **TOP NINE AUDIT ROADBLOCKS**

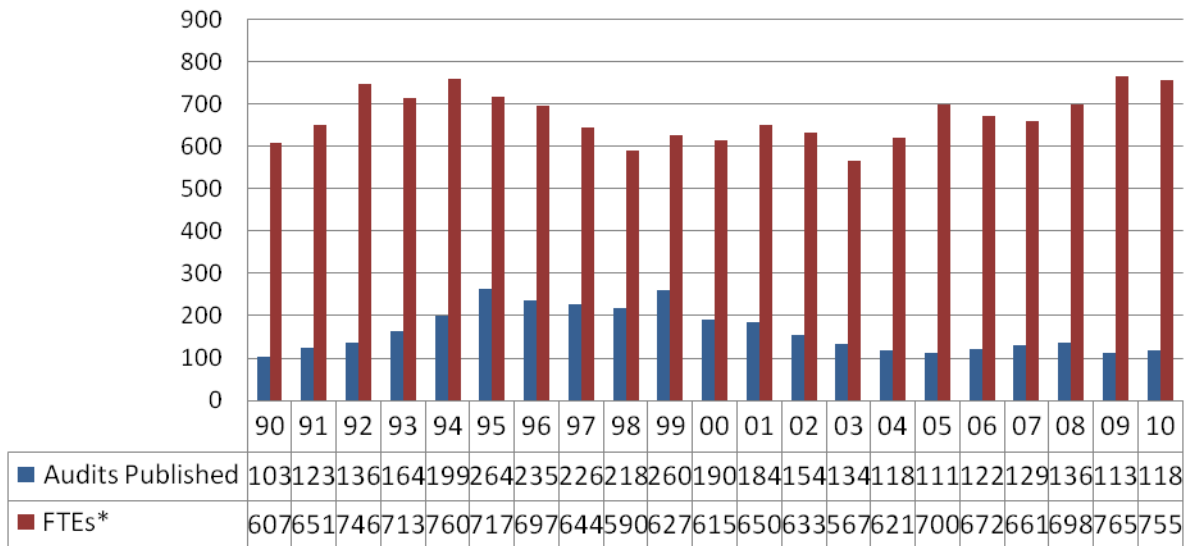
- 1) Top management lacks a clear and common vision of and commitment to the IG’s core mission – a problem that adversely affects every aspect of auditing;
- 2) Most audits are policy compliance reviews that yield zero financial benefits to the taxpayers;
- 3) Auditors are not on the “money trail” 24/7 where they need to be to detect and deter fraud and waste;
- 4) Auditors consistently fail to verify potential fraud and waste by connecting all the dots in the cycle of transactions; they need to match contract requirements with deliveries and payments using primary source documents; By making these match-ups, auditors will be positioned to answer key oversight questions: Did the government receive what it ordered at the agreed-upon price and schedule; or did the government get ripped off, and if so, by how much money?

- 5) Most audits take so long to complete that they are stale and irrelevant by the time they are published; Reasonable time-to-complete goals need to be set; then audit teams can be organized with the right skill sets to meet those goals;
- 6) Until the DOD accounting system is fixed, genuine contract and financial audits will require large audits teams if such reports are to be completed within a reasonable length of time;
- 7) Audit findings and recommendations are usually weak; responsible officials are rarely held accountable; and wasted or stolen money is rarely recommended for recovery or return to the Treasury;
- 8) While relentless follow-up is an important part of audit effectiveness, it is not practiced by the Audit Office;
- 9) Since DOD's broken accounting system is obstructing the audit process, contracts designed to fix that system need to be assigned a much higher audit priority;

**These are the issues that must be addressed and resolved if the audit reforms and transformation promised by IG Heddell and Deputy IG Blair are to become a reality.**

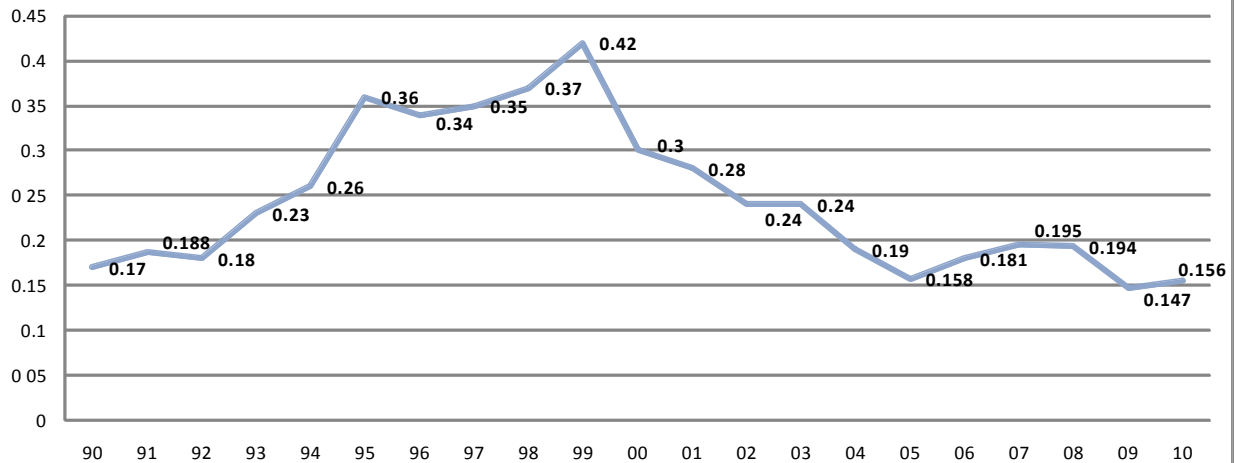
## APPENDIX

**Figure 1 - DOD OIG Published Audits and Staffing, 1990-2010**



\* Full-Time Audit Employees

**Figure 2 - DOD OIG Reports Per Auditor, 1990 - 2010**



## HHS

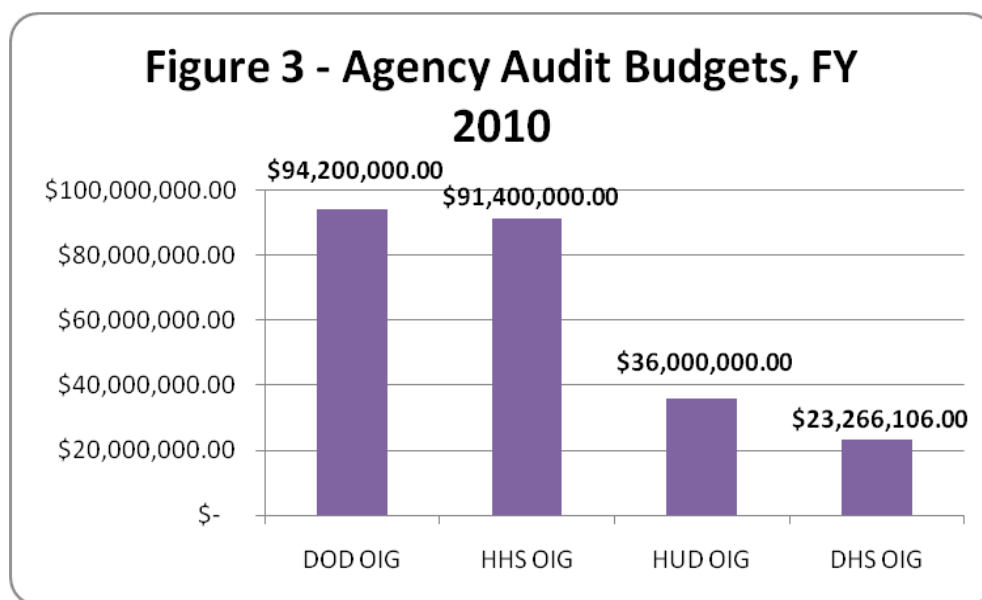
The HHS OIG Office of Audit Services (OAS) reported a budget of \$91.4 million in FY 2010.<sup>27</sup> Its OAS employed 734 staff and published 592 financial reports. Using a rough calculation for report costs, it is estimated that each published HHS OAS report cost the taxpayers approximately \$154,391.89. The average output per auditor was 0.807 audits per year. If potential savings are offset by total audit costs, this operation may have saved the taxpayers over \$200 million.

## HUD

The HUD OIG audit budget for FY 2010 was \$36 million. An audit staff of 306 full-time employees completed approximately 197 financial audits. Each HUD OIG fiscal audit cost about \$182,741.12. The average output per auditor was 0.644 audits a year.<sup>28</sup>

## DHS

At DHS OIG, the audit office had a total budget of almost \$23.3 million with an audit staff of 169, including 75 trained auditors. The DHS OIG conducted 95 financial audits at a cost of \$244,906.38 each with an average output per auditor of 0.562 audits per year.<sup>29</sup>

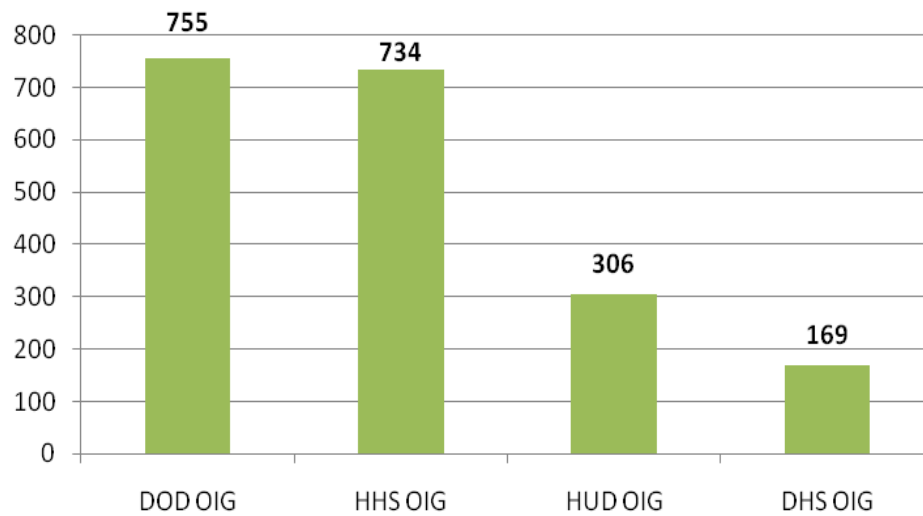


<sup>27</sup>HHS OIG/IO email, March 23, 2011;

<sup>28</sup>HUD OIG emails, March 10, 2011 and March 16, 2011;

<sup>29</sup> DHS OIG emails, March 22, 2011 and March 24, 2011;

**Figure 4 - Audit Staff, FY 2010**



**Figure 5 - Audits per Agency, FY 2010**

